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OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

November 21, 1983

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR CABINET AFFAIRS
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
ASSISTANT TO THE PRESIDENT & DEPUTY TO THE CHIEF OF STAFF
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT
CHAIRMAN, EXPORT-IMPORT BANK

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

A meeting of the SIG-IEP is scheduled to be held on Wednesday, November 23, 1983, at 11:00 a.m., in the Indian Treaty Room (Room 474, Old Executive Office Building). The agenda is as follows:

1. Export Credits and International Debt;
2. IDA VII;
3. U.S.-E.C. December 9 Trip Preparation Report; and
4. International Debt Update.

Agenda items 3 and 4 will be oral reports. A discussion paper on agenda item 1 was circulated last week. Attached is a discussion paper on IDA VII.

Attendance will be principal, plus one.

Donald T. Regan

Attachment

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SIG-IEP Paper
U.S. Participation in IDA VII

The following describes the status of negotiations for a seventh replenishment of the International Development Association (IDA VII) and the position taken by the United States in the negotiations. It also discusses the key interrelated issues of U.S. funding for IDA VII and the country allocation of the replenishment.

Status of Negotiations:

IDA VII negotiations began in November, 1982, for the purpose of arranging financing for IDA operations in the period after July 1, 1984.

There have been five IDA Deputies meetings:

(1) November 22-23 (Washington) - to discuss the terms and conditions of lending.

(2) February 1-2 (Paris) - to discuss eligibility and allocation criteria.

(3) March 29-30 (Copenhagan) - to discuss burden sharing.

(4) July 19-21 (Tokyo) - to discuss the size of IDA VII and legal/technical issues.

(5) September 24 (Washington) - to continue discussions on the size of IDA VII.

Negotiations, which will resume December 9 in Paris, are now at a decisive stage. There is donor consensus that an IDA VII agreement is desirable by year-end to provide donors with adequate time to secure legislative approval which would ensure continuity in IDA operations for the period after July 1, 1984.

U.S. Approach to IDA VII:

IDA makes 50-year interest free loans to the world's poorest countries, generally those with a GNP per capita of $795 or less. We recognize that the IDA VII replenishment is important for these countries. IDA also constitutes one of the more visible forms of international economic cooperation with our allies.

However, quantitative measures that would clearly establish the degree of IDA effectiveness cannot be devised (e.g., estimates on the economic rate of return on individual IDA projects cannot tell us about the overall impact of such assistance on domestic savings and investment, foreign private capital inflows etc.). Furthermore, institutions, policies and incentives are at least as important as concessional aid flows in the process of economic development.

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While IDA's policy dialogue and institution building capabilities are important, it is also important not to overstate the contribution of IDA in the desired economic development of IDA recipients. We have been working hard to focus IDA Management's attention on the importance of improving conditionality and liberalizing "price" and other distortions in the economies of IDA recipients. IDA is a project-oriented, not balance of payments oriented, lender.

U.S. goals for IDA VII can be categorized in three broad areas:

(a) improved loan quality and efficiency of resource use (9% of all IDA projects have a negative rate of return and an additional 11% have a rate of return of less than 10 percent.)

(b) a country lending allocation which better focuses on the poorest and least creditworthy countries, and

(c) a financial and operating framework which more realistically reflects existing economic conditions and includes a level of U.S. participation which reflects U.S. budgetary realities and has Congressional support.

* The Administration considers it particularly important to avoid the funding uncertainties which have characterized U.S. contributions to IDA VI. Such uncertainties hinder World Bank planning for IDA lending operations, generate friction with other donors, and detract attention from other important issues we wish to pursue in IDA. Thus the importance of adequate Congressional support for the replenishment and for the negotiated level of U.S. participation.

Major Issues

(a) Level of U.S. Participation:

Since December 1981, the budget has included $750 million as the outyear planning number for future U.S. contributions to IDA. This $750 million annual planning figure assumed -- consistent with the Administration's MDB assessment -- an increased IDA focus on Sub-Saharan Africa and continued "maturation" of India into hard window borrowing.

While some Members of the Congress, primarily from the authorizing committees (House Banking Committee and Senate Foreign Relations Committee), have expressed a willingness to consider an IDA VII contribution above the $750 million level, such a position most probably is not sustainable in either the House and Senate Appropriations Committees or the general membership of the House and Senate.

At the March IDA Deputies Meeting, the U.S. Deputy stated "that a United States share in IDA VII of no larger than 25 percent would be an appropriate reflection of our economic assistance policy." At the July meeting, the U.S. Deputy

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stressed that $750 million should be viewed as the maximum annual contribution to IDA VII. We reinforced these positions at the recent Washington meeting. We have also encouraged other donors who were in a position to do so to increase their share, noting our willingness to reduce the U.S. share below 25 percent and thus increase the size of the replenishment while still maintaining the annual $750 million contribution.

It is the considered judgment of the Treasury Department that any increase above $750 million would encounter strong Congressional opposition and could jeopardize prospects for securing the $150 million still needed to complete U.S. IDA VI contributions as well as other foreign assistance requests.

(b) The Size of IDA VII:

The Bank proposed an IDA VII of "at least $16 billion" (in a three-year replenishment) as necessary for IDA to meet the objectives for which it was established. Some donors supported the $16 billion level, while others favored the same nominal level as IDA VI ($12 billion) or a level in between $12 billion and $16 billion.

There is now widespread recognition among IDA Deputies that an IDA VII of $16 billion is not realistic and that it will be difficult to achieve even the $12 billion level initially negotiated for IDA VI. At the same time, there is widespread opposition to a $9 billion replenishment, i.e., the level implied by an annual U.S. contribution of $750 million and a 25 percent U.S. funding share over three years. A $9 billion three-year IDA would support annual IDA lending commitments of roughly $3 billion.

While the $750 million U.S. funding level has been widely criticized, a number of other donors also have budgetary constraints, with some having experienced significant currency depreciations vis-a-vis the U.S. dollar. Up to now, these countries have let the United States assume the full onus for exerting downward pressure on the size of IDA VII. However, Japan has recently informed us that they could accept a $9 billion Replenishment.

IDA lending peaked in FY 80 at $3.8 billion. IDA VI was intended to finance average annual commitments of $4.1 billion in FY 83. As a result of the U.S. stretch-out and the significant depreciation of many donors' currencies vis-a-vis the U.S. dollar, average annual commitments are now expected to be about $3.2 billion a year in FY 81-84 even though other donors provided $2 billion in additional FY 84 contributions.

	IDA VI Commitments as Initially Envisioned	IDA VI Commitments Latest Projection
FY 81	$ 3,500 million	$ 3,482 million
FY 82	$ 4,100 million	2,686 million
FY 83	$ 4,700 million	3,341 million
FY 84	-	3,300 million

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The fact that we view IDA as primarily a "hard" project lender for long-term development is also relevant to the size issue. Such projects take time to develop, particularly when policy reform is necessary. We do not believe IDA recipients' needs for "soft" projects, e.g., lines of credits for imports or budget support, should be used in justifying its capital requirements.

(c) Country Lending Allocation:

IDA has increased its lending emphasis on Sub-Saharan Africa with lending to this region accounting for almost one-third of FY 81-83 IDA commitments. India's traditional 40 percent share of IDA resources was reduced to 37 percent in FY 81, to 33.5 percent in FY 82, and to 31.8 percent in FY 83. Since China was not a member of the Bank when IDA VI was negotiated, it is receiving only a relatively small percentage (2.2% in FY 82 and 4.5% in FY 83) of IDA VI resources.

At the February IDA Deputies meeting, the Bank proposed that the combined ceiling for India and China be 40-50 percent of IDA VII, with the ceiling rising as the size of the replenishment increased, i.e., from a 40 percent ceiling in a $9.9 billion replenishment to a 50 percent ceiling in a $17.6 billion replenishment. The allocation proposed by the Bank for Sub-Saharan Africa would decrease from 30 percent in a $9.9 billion replenishment to 26 percent in a $17.6 billion replenishment.

The U.S. position was that:

-- the countries of Sub-Saharan Africa and other least developed countries should have first claim on IDA resources as long as these countries are able to make effective use of these resources.

-- the combined India/China ceiling should be below 40 percent and, on a comparative basis of both poverty and creditworthiness standards, India should receive a larger share of IDA VII resources than China.

In the $16 billion "minimum" IDA VII replenishment proposal discussed in Tokyo, the Bank envisioned the following allocations:

	Actual FY 81-83		Estimated FY 85-87	
	$ billion	Percent	$ billion	Percent
SUB-SAHARAN AFRICA	3.0	32	6.0	37.50
OTHER "PURE IDA" COUNTRIES a/	1.8	19	3.0	18.75
OTHER "BLEND" COUNTRIES b/	4.4	46	7.0	43.75
FORMER IDA BORROWERS	.3	3	-	-
	9.5		16.0	

a/ 13 countries, the dominant recipient being Bangladesh which in FY 82 accounted for 63% of the commitments going to this group.

b/ four countries: India, China, Sri Lanka and Pakistan.

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Such a distribution would suggest two significant shifts in country allocation policy since the issue was discussed in February: (1) increased emphasis on Sub-Saharan Africa, and (2) a lower ceiling for India/China. (If one assumes that the two "other blend" countries, Sri Lanka and Pakistan, would obtain a 8 percent share of total IDA commitments -- they averaged 9.4% in the FY 80-82 period -- the combined India/China share suggested is about 36 percent.)

Assuming some minor alterations (i.e., increasing the shares of Sub-Saharan Africa by 1.5% and "Other Pure IDA Countries" by 2.25%, and decreasing the share of other "Blend" Countries by 3.75%) in the allocation percentages noted above, a $9 billion IDA VII could result in the following distribution:

	Share	Over 3 Years	Yearly
Sub-Saharan Africa	39.0%	$ 3,510 mil.	$ 1,170 mil.
Other Pure IDA Countries	21.0%	$ 1,890 mil.	$ 630 mil.
Other "Blend" Countries	40.0%	$ 3,600 mil.	$ 1,200 mil.
		$ 9,000 mil.	$ 3,000 mil.

-- implies a nominal increase in annual lending to Sub-Saharan Africa which averaged $1.0 billion in FY 81-83.

-- implies a modest nominal increase (about $30 million per year) in lending to the 13 other pure IDA countries.

-- implies a nominal decrease (about $270 million per year) in lending to the India/China/Sri Lanka/ Pakistan group. However, as can be seen in the illustrative scenario in TAB A, this could be structured in a rational fashion which would:

* imply only modest maturation of Sri Lanka and Pakistan (reducing the combined share in IDA of these two countries from 9.4% in FY 80-82 to 8% in IDA VII),

* continue the maturation of India, while still allowing India's total World Bank borrowings to increase in nominal terms vis-a-vis the annual borrowings of the last several years, and

* allow a gradual and modest increase in lending to China during the IDA VII period.

IDA Deputies have agreed that "the eligibility for IDA resources should remain per capita income and countries' access to other sources of finance." In this context, we have asked that the December meeting review the creditworthiness of IDA recipients, so as to better ascertain to what extent prospective

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borrowers have access to -- and the ability to service -- alternative sources of finance. We believe such a review would strengthen the claim of Sub-Saharan Africa to IDA VII resources, while also pointing out the relatively favorable creditworthiness of China -- which recorded a 1982 balance of payments surplus of $7.3 billion, and reserves up by $6.3 billion, with a $6.8 billion payments surplus projected for 1983 -- and to a lesser extent India.

While we believe that Sub-Saharan Africa should -- on the basis of need and lack of access to alternative financing -- have first claim on IDA resources, we also recognize that there are some very difficult operational problems associated with this region, including absorptive capacity and sluggish economic performance. (As noted in the 1982 IDA in Retrospect report, the average rate of return on IDA projects in Africa is considerably below that of South Asia, with 14 percent of African projects having a negative rate of return and an additional 16 percent of projects having a rate of return below 10 percent.) We do not therefore accept the Bank's contention that Sub-Saharan Africa could effectively utilize $6 billion, i.e., double FY 81-83 lending, in IDA VII. Our goal would be for a far more modest increase in lending to the region -- e.g., from $3.0 billion in FY 81-83 to $3.5 billion in FY 85-87 -- which should be accompanied by renewed efforts in the areas of technical assistance, training, and human resource development as the IDA in Retrospect report recommended.

(d) Length of Replenishment:

At the March IDA Deputies meeting, the United States proposed a five-year period rather than the three-year time frame of recent replenishments. We pressed this proposal at the July meeting, emphasizing that a five-year period would facilitate legislative and long-range operational planning. There was virtually no support among other donors for the five-year, rather than three-year, replenishment.

(e) Terms and Conditions of Lending:

At the November Deputies meeting, Deputies were open to the idea of reducing the maturity of IDA credits but most were not enthusiastic to levy interest charges on these credits feeling that more study should be given to the possibilities for expanding the use of blending for altering the concessionality of combined IBRD/IDA resources. There was also strong feeling that it was premature to reach any conclusions on specific changes in terms until it became clearer how other issues affecting the size and allocation of resources would be resolved.

It should be noted that the present terms for IDA credits were established in 1960 and have remained essentially unchanged since then. Under these terms, IDA credits are provided for a 50-year maturity period with ten years grace. Rising inflation

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and interest rates have made IDA credits more attractive to borrowers. In line with generally rising capital costs, the element of concessionality (or the grant equivalent) of IDA credits has risen from 65 percent in 1961 to 90 percent in 1982. A significant shortening of the amortization terms would enable funds to be recycled with relatively little deterioration in grant terms.

Other Donors' Positions

Negotiation of a replenishment above $9 billion would require either an increased annual U.S. contribution above the $750 million now envisioned or a willingness by other donors to significantly increase their share in the replenishment. However, among the major donors, only Japan has suggested the possibility of increasing its share.

It appears likely that donors will continue to support increased IDA lending to Sub-Saharan Africa, although even in a $9 billion replenishment there will still be considerable donor support (particularly from the UK and Canada) for a large program for India. Japan is also likely to emphasize the importance of a program for China. The larger the size of the replenishment, the greater will be the Bank's flexibility to downplay creditworthiness criteria and accommodate larger programs for India and China.

TAB A: Illustrative IDA VII Lending Scenario for "Other Blend" Countries

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ILLUSTRATIVE SCENARIO: IDA VII LENDING TO "OTHER BLEND COUNTRIES"

1. Assumes "other blend countries" will receive a 40 percent share of IDA VII resources (vis-a-vis a 46% share in FY 81-83) during the FY 85-87 period. Also assumes the 40 percent share will be distributed as follows:

	FY 85	FY 86	FY 87
Sri Lanka + Pakistan	8.0%	8.0%	8.0%
India	27.5%	25.5%	23.5%
China	4.5%	6.5%	8.5%

2. Continues the maturation of India, while still allowing total Indian World Bank borrowings to increase in nominal terms vis-a-vis Indian borrowings over the last several years.

World Bank Lending to India

($ millions)

	IDA		IBRD		TOTAL WORLD BANK	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Actual						
FY 73	494	36	70	3	564	17
FY 74	390	36	52	2	442	10
FY 75	631	40	209	5	840	14
FY 76	684	41	210	4	894	13
FY 77	481	37	269	5	750	11
FY 78	952	41	330	5	1,282	15
FY 79	1,192	39	300	4	1,492	15
FY 80	1,535	40	125	2	1,660	14
FY 81	1,281	37	430	5	1,711	14
FY 82	900	33.5	1,265	12	2,165	17
FY 83	1,063	31.8	1,087	10	2,151	15
Illustrative						
FY 85	825	27.5	1,330	10	2,155	13
FY 86	765	25.5	1,406	9.5	2,171	12
FY 87	705	23.5	1,476	9	2,181	11

Note: IBRD borrowings are based on currently projected overall lending levels for the Bank, i.e., $13.3 billion (FY 85), $14.8 billion (FY 86), and $16.4 billion (FY 87).

India's share of total IBRD lending is projected to begin declining in FY 86 to reflect Bank concerns regarding the quality of its portfolio as well as internal Bank guidelines

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for limiting the proportion of IBRD lending allocated to a specific country. The guidelines are that:

(a) the ratio of a country's disbursed and outstanding loans to total Bank disbursed and outstanding loans should not exceed 8 percent (India's 6/30/83 ratio was 4.1 percent), and

(b) the ratio of a country's total loans, i.e., loans outstanding, undisbursed loans, and loans approved but not yet effective, to total Bank loans should not exceed 10 percent (India's 6/30/83 ratio was 5.5 percent)

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3. Allows a gradual and modest increase in IDA lending to China during the IDA VII period.

IDA Lending to China

($ millions)

		Amount	% of Total
Actual	FY 81	100	2.9
	FY 82	60	2.2
	FY 83	150	4.5
Illustrative	FY 85	135	4.5
	FY 86	195	6.5
	FY 87	255	8.5

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